

# Transitional Arrangements for Property-Based Incentive Schemes



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## Introduction

Generally speaking, transitional arrangements in the case of property-based incentive schemes refer to arrangements put in place in the context of various deadline extensions as part of the phasing out of the various schemes. The arrangements are designed to ensure that pipeline projects may benefit from these deadline extensions. However, only projects which are at a certain degree of advancement will usually benefit, for example, a person may be required to have entered into a binding contract with a builder or to have completed a certain percentage of the cost of the project by a specified date.

Since their introduction, most of the property-based incentive schemes have had their termination dates extended on several occasions and these extensions have been conditional on a variety of transitional arrangements being met. In recent years, these arrangements have become more complicated and have been the subject of several Revenue 'Tax Briefing' articles and e-briefs. This document brings together and reproduces the relevant articles.

## Summaries of Tax Briefing Articles

Prior to Finance Act 2004, the termination date for most of the property-based incentive schemes was 31 December 2004. Finance Act 2004 extended the termination date from 31 December 2004 to 31 July 2006. The new termination date applied only to projects in respect of which a valid application for full planning permission was received by the relevant local authority by 31 December 2004 and where the work to which the expenditure was attributable was covered by that planning application. **Tax Briefing 60** in August 2005 contained an article outlining the Revenue view of how this condition would operate. The article also dealt with a Revenue precedent in relation to certificates issued by local authorities certifying that 15% of a project's total cost had been incurred under the Integrated Area Urban Renewal Scheme. The extended 31 July 2006 deadline for the latter scheme was not subject to the December 2004 planning condition. The Tax Briefing 60 article is reproduced at page 4.

Finance Act 2006 further extended the termination date of the various schemes from 31 July 2006 to 31 December 2006 where existing conditions had been met and to 31 July 2008 where additional new conditions were met. **Tax Briefing 63** in May 2006 contained an article outlining the existing and new conditions. The new conditions involved a requirement for a binding written contract for the construction work to be in place by 31 July 2006 and for work to the value of at least 15% of the actual construction costs to have been carried out by 31 December 2006. The article also provided details of ceilings introduced on the amount of expenditure qualifying for relief in 2007 and 2008. A table summarised the changes and the schemes affected. The Tax Briefing 63 article is reproduced at page 8.

**Tax Briefing 64** in August 2006 addressed a number of issues that were raised in relation to the article in Tax Briefing 63. One of these issues was the interaction of the extended write-off period of 25 years for hotels (introduced by Finance Act 2003) with the requirement for hotels to be registered with Fáilte Ireland (introduced by Finance Act 2005) and the transitional arrangements introduced by Finance Act 2006. Further clarification was provided on the new 'binding contract' condition and the requirement for work to the value of at least 15% of the actual construction costs to have been carried out by 31 December 2006. The Tax Briefing 64 article is reproduced at page 13.

**Tax Briefing 65** in December 2006 contained an example that illustrated how the Finance Act 2006 transitional arrangements would operate. It also contained an article that provided further clarification in relation to the new 15% of construction costs test to be met by 31 December 2006. The Tax Briefing 65 articles are reproduced at pages 18 and 20.

The relevant articles are reproduced below.

## TAX BRIEFING 60

### Property-based incentive schemes

#### Transitional Arrangements For Property-Based Incentive Schemes

##### Introduction

The Finance Act 2004 extended the termination date for a number of property-based tax incentive schemes from 31 December 2004 to 31 July 2006 subject to certain transitional requirements being met. The purpose of the extension was to facilitate the orderly completion of projects already in the pipeline. The new termination date of 31 July 2006 applies only to projects in respect of which a valid application for full planning permission was received by the relevant local authority on or before 31 December 2004. Thus, the benefit of the 31 July 2006 time extension applies to expenditure incurred on or before that date on the construction, refurbishment or conversion of a building or structure, where that expenditure is expenditure in respect of work which is covered by a valid application for full planning permission received by the relevant local authority on or before 31 December 2004. Under planning and development legislation local authorities may not accept planning applications during the period 24 December to 1 January. Despite some local authorities making arrangements to accommodate applicants, it appears that some who attempted to submit applications within the period 24 December 2004 to 31 December 2004 were unable to do so. **In the circumstances, Revenue are prepared to make allowances for this situation and will regard planning applications acknowledged as received by local authorities on or before 7 January 2005 as meeting the statutory deadline. Therefore, references throughout this article to 31 December 2004 should be read as references to 7 January 2005.**

The schemes affected are -

- Town renewal
- Rural renewal
- Student accommodation
- Living over the Shop
- Park and Ride

The Finance Act 2004 also extended the deadline for the urban renewal scheme to 31 July 2006 again where certain transitional requirements are met. The extension applies only to projects in respect of which 15% of the total project costs had been incurred on or before 30 June 2003 and a certificate to this effect had been received from the relevant local authority on or before 30 September 2003.

The purpose of this article is to clarify issues raised in relation to satisfying the various transitional requirements in order to qualify for the extended 31 July 2006 deadline. As well as the schemes mentioned above, similar issues arise in the case of the transitional requirements for certain hotel projects. For hotel projects for which the necessary requirements are satisfied, allowances may continue to be claimed over 7 years instead of the 25 year write-off period introduced for new hotel projects.

##### Planning applications

*Section 372AL(1A) TCA 1997* provides the legislative basis for the extended deadline of 31 July 2006 for the residential element of the various schemes mentioned above. *Sections 372AA, 372L, 372A(1B) and 372U TCA 1997* do likewise for the commercial and industrial elements of the town renewal, rural renewal, living over the shop and park and ride schemes

respectively. The provisions ensure that expenditure incurred on or before 31 July 2006 will qualify for relief **provided that it is expenditure incurred on work that is covered by a valid application for full planning permission that was received by the relevant local authority on or before 31 December 2004.** The time extension does not apply to projects where the application for planning permission was received after that date. It should also be noted that where a valid planning application for full planning permission was received on time, relief is only available in respect of expenditure on actual work covered by that particular application. It does not extend to expenditure on additional work as would arise where the applicant decides to extend the scale of the project subsequent to the qualifying planning application deadline.

In this regard, Revenue is concerned at some notices that have appeared in newspapers after the 31 December 2004 deadline indicating that "significant further information has been lodged with \_\_\_\_ County Council under planning reference xxx, 2004". In some cases the "significant further information" referred to would have the effect of substantially increasing the scale of projects already submitted. Where a project proceeds on the basis of the planning application that is submitted by 31 December 2004, only expenditure incurred on the basis of the original project will qualify for relief and that expenditure incurred on any extension or addition to a project will not qualify for relief. In such a situation it will be necessary for the total expenditure to be apportioned between the qualifying and the non-qualifying work. If, on the other hand, the planned extension gives rise to the need to make a further planning application after 31 December 2004 to cover the revised or extended project, then none of the expenditure incurred on that project will qualify for relief. The position is the same where an applicant is required for any other reason to submit a further planning application in respect of a project after 31 December 2004. In all such cases no relief is available.

### **Sale of Site/Building**

A person who owns a site or a building that is to be refurbished or converted may wish to sell the site or the building after he or she has applied for or obtained planning permission. In such a situation the purchaser of the site or the building will be treated in exactly the same way as the original applicant or vendor and will only qualify for relief to the extent that the work that is carried out on the project is that provided for in the original valid application for full planning permission received on or before 31 December 2004.

### **Qualifying expenditure incurred**

Qualifying capital expenditure for the purposes of availing of the extended deadline of 31 July 2006 means capital expenditure incurred on construction, refurbishment or conversion work covered by a valid application for full planning permission received by a local authority on or before 31 December 2004. For capital allowances purposes the general position is that expenditure is incurred not when the amounts in question are paid but rather when those amounts become legally payable to the person carrying out the work. However, this does not apply in the case of the extended termination date for the incentive schemes covered in this article and for hotel projects. Instead, only so much of the expenditure incurred as is properly attributable to work that is actually carried out in the period up to 31 July 2006 can be treated as having been incurred in that period.

Following are a number of examples. These are for illustrative purposes only and are not intended to convey any view on the workings and decisions of the planning process.

### **Example 1**

Mrs. Murphy submitted a valid application for full planning permission for the construction of a house to a local authority under the rural renewal scheme on 1 December 2004. Planning

permission was granted for the house on the basis of the planning application received and no revisions were required. If all work on the house is carried out on or before 31 July 2006 in accordance with the planning application the full amount of the expenditure incurred will qualify for relief.

### **Example 2**

Mr. O'Brien submitted a full and valid planning application for the living over the shop scheme on 5 December 2004. The local authority was not satisfied with the amount of private open space and refuse storage area that was proposed. However, it accepted the planning application but required Mr. O'Brien to provide an additional balcony and a covered storage area in the rear yard. Conditions relating to the additional work were attached to Mr. O'Brien's planning permission. The cost of constructing the additional balcony and the covered storage area will qualify for relief as this work was necessary to meet the local authority's requirements in relation to the valid planning application submitted before the deadline.

### **Non-qualifying expenditure**

Where a planning application in respect of a project is received by a local authority after 31 December 2004, expenditure on that project will not qualify for relief. This is also the position where a planning application, originally made on time, is refused by a local authority and a further application is subsequently made after the 31 December deadline. The same position holds where an applicant, having successfully obtained planning permission before 31 December 2004, wishes to make changes to a project necessitating the submission of a further planning application after the deadline. Finally, any expenditure incurred on any additional work or any extension to a project outside or beyond the terms of a valid planning application received by 31 December 2004 will not qualify for relief.

### **Example 3**

Mr. Ryan submitted a full and valid planning application for an apartment block to be used as student accommodation on 20 December 2004. In January 2005 he decided to alter the project by adding an extra floor comprising four apartments. The local authority required him to submit a further planning application for the entire apartment block. None of the expenditure incurred on the apartment block will qualify for relief as work on the project will have proceeded in accordance with the second planning application submitted after 31 December 2004.

### **Hotels**

The Finance Act 2003 provided that the write-off of capital expenditure incurred on hotels would be made over 25 years instead of over 7 years. However, transitional provisions were put in place to retain the 7 years write-off regime to cater for certain pipeline projects. These transitional provisions ensure that where capital expenditure is incurred on a hotel project on or before 31 July 2006 and that project is the subject of a valid application for full planning permission received by the relevant local authority on or before 31 December 2004, the expenditure can be written off at the rate of 15% per annum for the first 6 years and 10% in year 7. For all other hotel projects the new 25-year write-off regime applies.

The position outlined above in relation to the treatment of the transitional provisions pertaining to the various property incentive schemes also applies in the case of pipeline hotel projects.

### **Holiday cottages**

The Finance Act 2003 terminated the availability of capital allowances for expenditure incurred on holiday cottages. However, transitional provisions were put in place to cater for

certain pipeline projects. These transitional provisions ensure that where capital expenditure is incurred on a holiday cottage on or before 31 July 2006 and that holiday cottage is the subject of a valid application for full planning permission received by the relevant local authority on or before 31 December 2004, capital allowances will be available in respect of that expenditure.

The position outlined above in relation to the treatment of the transitional provisions pertaining to the various property incentive schemes also applies in the case of pipeline holiday cottage projects.

### **Urban renewal scheme - 15% certificate**

The 31 December 2004 deadline for the submission of planning applications does not apply in the case of the urban renewal scheme. Instead, to qualify for the extended termination date of 31 July 2006, a developer or other person must have incurred 15% of the total cost of a project on or before 30 June 2003 and a certificate to this effect must have been received from the relevant local authority on or before 30 September 2003. It is not open to the recipient of the certificate to subsequently increase the scale of the project for which the certificate was issued.

The relevant legislation requires the certificate to be given to the person carrying out the project or development. However, Revenue published a precedent in 1998 stating that -

*“In the event of a development site being sold, the person constructing, converting or refurbishing the building may be regarded as the person to whom the relevant local authority has given a certificate under Section 339(2)(a) TCA 1997 if no change occurs in the project as submitted by the vendors.”*

Section 339(2)(a) TCA 1997 refers to the 1994 urban renewal scheme. Revenue also applies this precedent to the current urban renewal scheme and, in the circumstances, interprets it strictly. It does not hold in situations where the purchaser(s) of a site or a building for which a 15% certificate has been issued makes changes to the original project which was the subject of the certificate or substitutes new plans for those already submitted to the local authority by the vendor when applying for the certificate. While the physical aspects of a project must not change following the sale of the site or building, an increase in costs due to delay in proceeding with the project will not invalidate the project for relief purposes.

Where a site is split into separate parts before being sold on or otherwise transferred, the separate parts will be considered by Revenue as a whole for the purposes of deciding whether there has been a change in the project. Any development undertaken by or on behalf of the new owners of individual parts of a site, for instance, must combine to deliver the project in respect of which the local authority issued the original certificate. Therefore, the entitlement to relief of each of the parties carrying out the project will depend on the actions of the other parties involved.

## TAX BRIEFING 63

### CAPITAL ALLOWANCES AND PROPERTY-BASED INCENTIVE SCHEMES

#### Finance Act Changes

The Finance Act 2006 contains several sections affecting residential reliefs ('section 23' type relief and owner-occupier relief) and capital allowances for the property-based incentive schemes. This article provides some details of the new provisions.

#### Terminating schemes

A table at the end of the article summarises the Finance Act changes for the terminating schemes.

#### Termination Dates

Extended termination dates apply to expenditure qualifying for residential reliefs and to expenditure qualifying for capital allowances for certain commercial and industrial developments. The deadline by which qualifying expenditure must be incurred is extended from 31 July 2006 to 31 December 2006 where existing conditions have been met. This new termination date is further extended to 31 July 2008 where additional conditions are met. The schemes affected and the details of the existing and new conditions are set out below.

<b>Residential Schemes Section 23/ Owner-occupier</b>	<b>Commercial and Industrial Buildings Capital allowances</b>
Urban Renewal	Urban Renewal
Rural Renewal	Rural Renewal
Town Renewal	Town Renewal
Living over the Shop	Living over the Shop
Park and Ride	Park and Ride
Student Accommodation	Hotels**
General rental refurbishment*	Holiday Camps**
	Registered Holiday Cottages
	Sports Injuries Clinics***
	Multi-Storey Car Parks
	Third-Level Education Buildings
	Nursing Home Residential Units****

\*There had previously been no termination date for the general rental refurbishment scheme. The termination date of 31 July 2008 now applies without condition. This is a countrywide scheme for the refurbishment of rented residential properties. Tax relief for qualifying expenditure is given against rental income at the rate of 15% per annum for 6 years and 10% in year 7 rather than by means of 'section 23' type relief with a full deduction in year 1. *Section 11 Finance Act 2006* introduced a new condition for eligibility for relief by making entitlement to relief dependent on compliance with the registration requirements of the Residential Tenancies Act 2004. (This issue of *Tax Briefing* contains an article on these registration requirements).

\*\*Capital allowances will continue to be available for hotels and holiday camps that are registered with Fáilte Ireland. However, for those buildings that fall outside the current transitional arrangements the capital allowances will only be available at an annual rate of 4% instead of the 'accelerated' rate of 15%.

\*\*\*There was previously no termination date for incurring qualifying expenditure on sports injuries clinics. The period during which the Health Services Executive is required to provide annual certification in respect of a sports injuries clinic is extended from 7 to 10 years.

\*\*\*\* The original termination date for incurring qualifying expenditure on nursing home residential units was 24 March 2007. Although these units are residential, they qualify for capital allowances as an industrial building rather than for the usual 'section 23' type relief for residential developments. A unit will now be treated as a qualifying unit in circumstances where a unit is leased directly to a registered nursing home, provided that it is leased on condition that it is subsequently leased by the registered nursing home to an elderly or infirm person and is not used for other purposes. Previously, the unit did not qualify for capital allowances until it had actually been leased to the elderly or infirm person. See section on **Continuing Reliefs** for more changes in relation to nursing home residential units.

### **Existing conditions**

Where certain existing conditions are met the termination date is extended from 31 July 2006 to 31 December 2006. For the urban renewal scheme there is a requirement that 15% of the project costs must have been incurred on or before 30 June 2003 and the relevant local authority must have certified this on or before 30 September 2003. For multi-storey car parks there is a requirement that 15% of the project costs must have been incurred on or before 30 September 2003 and the relevant local authority must have certified this on or before 31 December 2003. For buildings used for the purposes of third-level education an application must have been submitted to the Minister for Finance on or before 31 December 2004. For some of the other schemes a valid application for full planning permission must have been lodged on or before 31 December 2004 (see *Tax Briefing* 60 for details). This latter condition applies to the following buildings or schemes:

- Hotels ('accelerated' allowances only)
- Holiday Camps ('accelerated' allowances only)
- Registered Holiday Cottages
- Rural Renewal
- Town Renewal
- Living over the Shop
- Park and Ride

### **Additional conditions**

The termination date is further extended to 31 July 2008 where certain additional conditions are met. Work to the value of 15% of the actual construction or refurbishment costs must be carried out on or before 31 December 2006. Unlike the earlier 15% expenditure condition for the urban renewal scheme and multi-storey car parks, the new 15% expenditure condition does not include the acquisition of the site or any costs associated with that acquisition.

For certain commercial and industrial projects, hotels etc. (listed below) where the extended 31 July 2008 deadline requires EU Commission approval, qualifying conditions are more onerous. Thus, a binding written contract for the construction or refurbishment work must be

in place by 31 July 2006 and the relevant local authority must certify compliance with the 15% requirement. An application for a local authority certificate must be made on or before 31 January 2007 and the certificate must be issued on or before 30 March 2007. A builder/developer who sells the completed building must provide the certificate to the purchaser. Such certification must include details of the actual expenditure that is incurred up to 31 December 2006 and of the projected expenditure to be incurred after that date. The amount of qualifying expenditure incurred in 2007 and 2008 is then restricted to and cannot exceed this projected amount. That amount is in turn subject to the 75% and 50% restrictions outlined below. Where the projected expenditure is exceeded the qualifying expenditure will be treated as incurred in the period 1 January 2007 to 31 December 2007 to the fullest extent consistent with work having actually been carried out during this period. Projects relating to the following are affected by these requirements:

- Hotels ('accelerated' allowances only)
- Holiday Camps ('accelerated' allowances only)
- Registered Holiday Cottages
- Urban Renewal (commercial and industrial buildings)
- Rural Renewal (commercial and industrial buildings)
- Town Renewal (commercial and industrial buildings)

Qualifying conditions for the new 31 July 2008 deadline for other cases and for the residential element of the above schemes where E.U. Commission approval is not required are less onerous. However, there is still a requirement for work to the value of 15% of the actual construction or refurbishment costs to have been carried out on or before 31 December 2006. While local authority certification is not required, the person claiming relief must be able to show that this condition has been met. Revenue expects that builders and developers will provide a statement prepared by a quantity surveyor or architect showing clearly the work that was carried out on or before 31 December 2006, the construction or refurbishment costs attributable to this work, the projected construction or refurbishment costs to completion of the project and the percentage of the total figure represented by the work that was carried out on or before 31 December 2006. This statement may be required in the event of an audit by Revenue. Therefore, a builder or developer who sells the completed building should provide this statement to the purchaser who will be claiming the relief together with the usual statement of costs and certificates of compliance/reasonable cost/consistency as appropriate. There is no requirement to have a binding contract in place by 31 July 2006. Neither is there any restriction of relief where the actual expenditure exceeds the projected post-December 2006 expenditure. However, the 75% and 50% restrictions in respect of expenditure incurred in 2007 and 2008, respectively, apply.

### **75% and 50% Restrictions**

There is a gradual reduction in the amount of expenditure qualifying for relief after 31 December 2006. Expenditure incurred during 2006 can qualify in full without restriction. However, only 75% of expenditure incurred in 2007 and 50% of expenditure incurred in the period between 1 January 2008 to 31 July 2008 can qualify for relief. In the case of nursing home residential units, expenditure incurred on or before 24 March 2007 (the original termination date) can qualify in full with expenditure incurred in the period between that date and 31 December 2007 being subject to the 75% cap. For the purposes of determining when expenditure is incurred, only the amount of the expenditure attributable to work actually carried out during a particular period is taken into account. Therefore, it is not possible to circumvent the deadlines by making an advance payment for materials or for work that will be carried out after the deadlines.

Persons claiming relief will need to know how to calculate the amount of relief that is due in respect of their particular property. Revenue expects that builders and developers will provide purchasers with sufficient information for this purpose. Thus, purchasers will need to know the value of the construction or refurbishment work that was carried out on or before 31 December 2006, during 2007 and in the period 1 January 2008 to 31 July 2008. This information may be required in the event of a Revenue audit. It should be noted that it is the amount of the actual construction or refurbishment expenditure, and not the amount of the relief, that is to be reduced by the 75% and/or 50% cap as appropriate. For the purposes of “the net price paid” formula in section 279 TCA 1997, the numerator “C” in the formula (see page 10 of *Tax Briefing* 60) should be the amount of the expenditure as appropriately reduced.

Scheme	Extension to 31/12/2006 Existing conditions	Extension to 31 July 2008		Cap on expenditure 75% 2007- 50% 2008	Section	
		Work = 15% costs by 31/12/06	Binding contract by 31/7/06		F.A. 2006	TCA 1997
Hotels ('accelerated' allowances)	Full and valid planning application by 31/12/04	Local authority to certify	Yes	Yes	26 27	270/316 268/272/274
Holiday Camps ('accelerated' allowances)	Full and valid planning application by 31/12/04	Local authority to certify	Yes	Yes	26 27	270/316 268/272/274
Registered Holiday Cottages	Full and valid planning application by 31/12/04	Local authority to certify	Yes	Yes	26 27	270/316 268/272/274
Multi-Storey Car Parks	15% project costs by 30/9/03 - certified by 31/12/03	Architect/quantity surveyor to certify	No	Yes	26 29	270/316 344
Sports Injury Clinics	No existing conditions No previous termination date	Architect/quantity surveyor to certify	No	Yes	26 28	270/316 268
Nursing Home Residential Units	No existing conditions	Work = 15% costs not required	No	100% to 24/3/07 75% 25/3/07 - 31/12/07 50% 1/1/08 - 31/7/08	26 37	270/316 268
Third Level Educational Buildings	Application to Minister for Finance by 31/12/04	Architect/quantity surveyor to certify	No	Yes	26 34	270/316 843
Urban Renewal	15% project costs by 30/6/03 - certified by 30/9/03	Local authority to certify commercial/Industrial Architect/quantity surveyor to certify residential	For commercial/ industrial only	Yes	25 26 30	372AL/372AS 270/316 372A/372B/372BA/372C/372D
Rural Renewal	Full and valid planning application by 31/12/04	Local authority to certify commercial/Industrial Architect/quantity surveyor to certify residential	For commercial/ industrial only	Yes	25 26 31	372AL/372AS 270/316 372L/372M/372N
Town Renewal	Full and valid planning application by 31/12/04	Local authority to certify commercial/Industrial Architect/quantity surveyor to certify residential	For commercial/ industrial only	Yes	25 26 33	372AL/372AS 270/316 372AA/372AB/372AC/372AD
Living over the Shop	Full and valid planning application by 31/12/04	Architect/quantity surveyor to certify	No	Yes	25 26 30	372AL/372AS 270/316 372A/372B/372BA/372C/372D
Park and Ride (including commercial/residential)	Full and valid planning application by 31/12/04	Architect/quantity surveyor to certify	No	Yes	25 26 32	372AL/372AS 270/316 372U/372V/372W
Student Accommodation	Full and valid planning application by 31/12/04	Architect/quantity surveyor to certify	No	Yes	25	372AL/372AS
General rented residential	No existing conditions No previous termination date	Work = 15% costs not required	No	Yes	11 25	372AM 372AL/372AS

## TAX BRIEFING 64

### CAPITAL ALLOWANCES AND PROPERTY-BASED INCENTIVE SCHEMES

#### Introduction

**Tax Briefing 63** contained an article on the Finance Act 2006 changes to the property-based incentive schemes. Following publication a number of issues were raised in relation to the article. This article addresses those issues. Also, in response to queries received, there is an example at the end of this article illustrating the application of the various restrictions put in place affecting hotels and certain other commercial and industrial projects etc benefiting from the extended 31 July 2008 deadline.

#### Hotels

##### Write-off over 7 years/25 years

The Finance Act 2003 extended the write-off period for capital expenditure on hotels from 7 years to 25 years. However, transitional arrangements were put in place in the Finance Acts 2003 and 2004 to retain the 7-year write-off regime to cater for certain pipeline projects. These transitional arrangements ensured that where capital expenditure was incurred on a hotel project on or before 31 July 2006 and that project was the subject of a valid application for full planning permission received by the relevant local authority on or before 31 December 2004, the expenditure could be written off at the rate of 15% per annum for the first 6 years and 10% in year 7. The new 25-year write-off regime, with expenditure being written off at the rate of 4% per annum, was to apply to all other hotel projects that did not meet the transitional arrangements.

The Finance Act 2006 extended the termination date for the 7-year write-off regime from 31 July 2006 to 31 December 2006 where the existing planning application conditions were met. New transitional arrangements in relation to expenditure incurred up to 31 July 2008 were also introduced. These provided that where there is a binding written contract for the construction or refurbishment work in place on or before 31 July 2006 and where work to the value of 15% of the actual construction or refurbishment costs (as certified by the local authority) is carried out on or before 31 December 2006, 75% of the expenditure incurred during 2007 and 50% of the expenditure incurred from 1 January 2008 to 31 July 2008 can be written off over 7 years, but subject to the ceiling of the projected expenditure as certified by the local authority (*see Tax Briefing 63 for full details of transitional arrangements and attached Example illustrating the application of the various restrictions*). For such transitional hotel projects the 25-year write-off regime will apply to:

- Expenditure incurred after 31 December 2006 where a binding contract is not in place by 31 July 2006 and work to the value of at least 15% of the actual construction or refurbishment costs is not carried out by 31 December 2006
- Any expenditure incurred after 31 July 2008 where a project is not completed by that date.

It should be noted that no allowances are available in respect of the remaining expenditure incurred up to 31 July 2008 in excess of the 75% and 50% thresholds. It should also be noted that the availability of capital allowances is subject to the requirement that the hotel be registered by Fáilte Ireland and to the transitional arrangements that apply in relation to registration.

## **Registration with Fáilte Ireland**

The Finance Act 2005 introduced a requirement for buildings or structures that are in use for the trade of hotel-keeping to be registered in the register of hotels kept by Fáilte Ireland under the Tourist Traffic Acts before they can qualify for capital allowances. This new registration requirement applies in respect of expenditure incurred on or after 3 February 2005, subject to transitional arrangements. These transitional arrangements are similar to those that were introduced by the Finance Acts 2003 and 2004 in relation to the extension of the write-off period from 7 years to 25 years (*see Tax Briefing 60 for details*). A hotel project that qualified for transitional treatment in relation to registration would not be concerned with the new registration requirement and could continue to claim capital allowances over 7 years in respect of all expenditure incurred on or before 31 July 2006. As indicated above, the Finance Act 2006 extended the period within which expenditure incurred could qualify for write-off over 7 years from 31 July 2006 to 31 December 2006 and to 31 July 2008 in certain circumstances. However, it did not extend the date from which the registration requirement would come into effect. This remains at 31 July 2006. Thus, no capital allowances will be available for expenditure incurred from 1 August 2006 unless the building or structure involved is included in the register of hotels kept by Fáilte Ireland. This is the situation even where the Finance Act 2006 transitional arrangements in relation to the extension of the 7-year regime to 31 December 2006 or 31 July 2008 are met.

## **Holding period/clawback of allowances**

It may happen that some of the expenditure incurred on the construction or refurbishment of a hotel will be written off over 7 years with the balance of the expenditure being written off over 25 years. This has implications for the period for which the hotel must be retained by the person claiming the capital allowances and in relation to the exposure to a balancing charge. In the case of, for example, a disposal of the hotel within 7 years of the hotel being first used (or first used after the refurbishment) all of the expenditure incurred will be taken into account in calculating any balancing charge/allowance. In the case of a disposal after 7 years but before 25 years, only the allowances in relation to that part of the expenditure that is being written off over 25 years will be subject to a balancing charge.

## **Binding Contracts**

One of the conditions for availing of the extended termination date of 31 July 2008 for some of the property incentive schemes is that a binding contract in writing, under which expenditure on the construction or refurbishment of a building or structure is incurred, must be in place for the particular building or structure on or before 31 July 2006. Clarification has been requested about certain aspects of this condition.

The extended deadline for the following buildings or schemes is subject to such a condition:

- Hotels ('accelerated' allowances only)
- Holiday Camps ('accelerated' allowances only)
- Registered Holiday Cottages
- Urban Renewal (commercial and industrial buildings)
- Rural Renewal (commercial and industrial buildings)
- Town Renewal (commercial and industrial buildings)

## **'Self-Construction'**

Revenue has been asked for a view about the need for a binding contract in a situation where the construction or refurbishment work on a building or structure is being carried out by the site owner, being either an individual or a company. Having regard to the fact that the projects in question all relate to commercial buildings and structures, Revenue would expect that most of these are unlikely to be undertaken by one person and that they would invariably involve the engagement of third parties to carry out some, or all, of the actual construction or refurbishment work. As there is a specific statutory requirement for a binding contract in writing to be in place by 31 July 2006, Revenue will expect that, in the absence of a global contract for the construction or refurbishment of a building, individual contracts for various elements of the construction or refurbishment work will be in place by that date.

In the exceptional situations where a site is owned by an individual or company and that individual or company will use only his/her/its own employees to carry out the development, without recourse to third parties, Revenue accepts that it would not be appropriate to insist on a binding contract between the site owner and another party. In such cases, Revenue will accept that the 'binding contract' condition is met where the site owner, whether an individual or company, swears an affidavit stating that the entire development will be carried out by the site owner's own employees. The affidavit should also contain a statement about the degree to which arrangements are in place to begin work on the particular project. It must be sworn on or before 31 July 2006. The employees must be employed directly by the site owner and not, for example, by an individual's development company where the site is owned by that individual.

## **Parties to contract**

As already stated, the binding contract must be one under which expenditure on the construction or refurbishment of the particular building or structure is incurred. It will be a question of fact in each case whether the contract meets this requirement. It is not necessary that the contract provides for investor entitlement to the capital allowances. It is sufficient that it provides for a binding commitment to the initial construction or refurbishment expenditure. The legislation is silent about the parties to such a contract. The type of contract put in place will depend on the type of project and the various parties involved in the development. It is not, therefore, possible to be prescriptive about the type of contract that Revenue would regard as satisfying the condition. Possible examples of acceptable contracts are a development agreement between a site owner and a development company that is responsible for delivering over a completed building, a building agreement between a site owner/development company and a builder or a building agreement between an investor and a development company/builder. Where there is a single global contract for a project comprising several individual buildings, the condition will be regarded as satisfied for each individual building. Where there are separate contracts for each building, for example, building agreements with each investor, and no single global contract, each building agreement will have to be in place on or before 31 July 2006.

(The above material has already been issued as e-briefs 26/2006 and 29/2006)

## **Documentation for investors**

A copy of the binding contract or affidavit (in the case of certain 'self-construction' projects) should be given to the investor(s) along with any other documentation that may be required to support a claim for capital allowances in the event of a Revenue audit.

## **15% Expenditure incurred by end 2006**

All of the terminating property incentive schemes, with the exception of the general countrywide refurbishment scheme, have a requirement for work to the value of at least 15% of the actual construction or refurbishment costs of the building or structure to be carried out

on or before 31 December 2006 in order to avail of the extended deadline of 31 July 2008. Clarification has been requested as to whether the 15% condition applies to the overall project or to each individual building.

In the case of industrial and commercial developments under the various schemes and in the case of hotels, holiday camps and registered holiday cottages, compliance with the 15% requirement must be certified by the relevant local authority. It is expected that issues relating to satisfying local authorities in relation to 15% certificates in these cases will be addressed in guidelines to be issued by the Department of the Environment, Heritage and Local Government in the near future.

In cases not requiring local authority certification such as in the case of residential developments under the various schemes, Revenue is prepared to accept that the 15% condition can be applied to the overall development rather than to each individual building. Revenue will, therefore, accept that where the 15% condition is satisfied in relation to an overall development, it will be treated as satisfied in relation to each individual building comprised in the development.

It should be noted that applications for local authority certificates must be made by 31 January 2007. Local authorities are obliged to issue certificates by 30 March 2007. A local authority certificate must contain the following information:

- A statement indicating whether it is satisfied or not that work to the value of not less than 15% of the actual construction or refurbishment costs of the building was carried out by 31 December 2006,
- The actual amount of the capital expenditure incurred on the building by 31 December 2006, and
- The projected balance of expenditure to be incurred on the building after 31 December 2006.

### **Commencement orders signed**

Following receipt of European Commission approval of the 31 July 2008 deadline extension from a State aid perspective, the Minister for Finance signed Commencement Orders on 26 June 2006 giving effect to the Finance Act 2006 changes. The Orders give effect to the changes introduced for the industrial and commercial aspects of the urban, rural and town schemes as well as to the changes made in relation to hotels, holiday cottages, third level educational buildings, park and ride facilities and multi-storey car parks.

#### **Example Illustrating the application of Finance Act 2006 Restrictions**

A builder purchases a site in a qualifying Urban Renewal area for €100,000 and constructs an industrial building on it for a cost of €420,000. The building is completed in August 2008 and, without having been used, the builder sells it to X on 1 October 2008 for €600,000 and X immediately takes it into use for the purposes of his manufacturing trade.

Construction expenditure attributable to the various periods is as follows

Year 2006: €100,000;  
Year 2007: €220,000;  
1 Jan. 2008 to 31 July 2008: €80,000;  
August 2008: €20,000.

The projected amount of post December 2006 expenditure, as certified by the local authority, was €280,000. Therefore the combined expenditure for the period 1 January 2007 to 31 July 2008 (€300,000) must be restricted to €280,000 and the restriction (€20,000) must be made

in relation to the period Jan. to July 2008 in priority to the year 2007. Accordingly, expenditure treated as incurred in the period Jan. to July 2008 (before the 50 per cent restriction is applied) is €60,000 (€80,000 less 20,000).

The amount of qualifying expenditure in each period after application of the 75 per cent and 50 per cent restrictions is as follows:

Year 2006: €100,000;  
Year 2007: €220,000 x 75% = €165,000;  
Jan. to July 2008: €60,000 x 50% = €30,000;  
August 2008: Nil (outside of the qualifying period).

Total expenditure for the purposes of the numerator "C" in the formula is therefore €295,000.

The net price paid by X for relief purposes under section 279 TCA (as amended) is –

B (purchase price) x  $\frac{C \text{ (expenditure in qualifying period as reduced by restrictions)}}{D \text{ (actual expenditure incurred) + E (site cost)}}$

i.e. €600,000 x  $\frac{€295,000}{€420,000 + €100,000} = €340,385$

X is deemed to have incurred construction expenditure on 1 October 2008 equal to the net price paid by him, that is, €340,385, and his entitlement to capital allowances will be based on that amount

**NOTE:** When calculating the formula for "the net price paid" in *Section 279* the numerator "C" in the formula should be the amount of construction expenditure (incurred in the qualifying period for the scheme) as reduced in accordance with subsections (5) and (7) of section 270. The denominator "C" in the original formula - now "D" in the revised formula - should include the full amount of expenditure incurred on the construction of the building or structure i.e. before any restrictions and whether or not incurred in the qualifying period for the particular scheme.

## TAX BRIEFING 65

### CAPITAL ALLOWANCES AND PROPERTY-BASED INCENTIVE SCHEMES

#### Introduction

**Tax Briefing 64** contained an article on the Finance Act 2006 changes to the property-based incentive schemes and addressed a number of issues raised in a previous article. It also contained an example illustrating the application of the various restrictions put in place affecting hotels and certain other commercial and industrial projects, etc. benefiting from the extended 31 July 2008 deadline. The example featured an industrial building in an urban renewal area with an element of expenditure on the building being incurred outside the qualifying period for the urban renewal scheme in August 2008. It has been drawn to our attention that, being an industrial building, such expenditure, though not qualifying under the urban renewal scheme, would qualify for relief under the general industrial buildings capital allowance regime. The purpose of this article is to point out that the example in Tax Briefing 64 more correctly reflects the position for a commercial building than an industrial building. A revised example is now attached illustrating the position for an industrial building and taking account of the fact that relief is available for such buildings outside the ambit of the various property-based incentive schemes.

#### Example Illustrating the Application of Finance Act 2006 Restrictions

A builder purchases a site in a qualifying Urban Renewal area for €100,000 and constructs an industrial building on it for a cost of €420,000. The building is completed in August 2008 and, without having been used, the builder sells it to X on 1 October 2008 for €600,000 and X immediately takes it into use for the purposes of his manufacturing trade.

Construction expenditure attributable to the various periods is as follows:

Year 2006: €100,000  
Year 2007: €220,000  
1 Jan. 2008 to 31 July 2008: €80,000  
August 2008: €20,000

As expenditure has been incurred on an industrial building within and outside the qualifying period for the urban renewal scheme, relief will be available under that scheme as well as under the general 25 year write off regime for industrial buildings in respect of that element of expenditure attributable to August 2008.

#### Relief under the Urban Renewal Scheme

The projected amount of post December 2006 expenditure, as certified by the local authority, was €280,000. Therefore the combined expenditure for the period 1 January 2007 to 31 July 2008 (€300,000) must be restricted to €280,000 and the restriction (€20,000) must be made in relation to the period January to July 2008 in priority to the year 2007. Accordingly, expenditure treated as incurred in the period January to July 2008 (before the 50 per cent restriction is applied) is €60,000 (€80,000 less €20,000).

The amount of qualifying expenditure in each period after application of the 75 per cent and 50 per cent restrictions is as follows:

Year 2006: €100,000  
Year 2007: €220,000 x 75% = €165,000  
Jan to July 2008: €60,000 x 50% = €30,000

August 2008: Nil (outside of the qualifying period). Total expenditure for the purposes of the numerator "C"\* in the formula is therefore €295,000.

The net price paid by X for relief purposes under *Section 279 TCA* (as amended) is –

$$B \times \frac{C}{D + E}$$

Where

B = purchase price

C = expenditure in qualifying period as reduced by restrictions

D = actual expenditure incurred

E = site cost

$$\text{i.e. } \text{€}600,000 \times \frac{\text{€}295,000}{\text{€}420,000 + \text{€}100,000} = \text{€}340,385$$

X is deemed to have incurred construction expenditure on 1 October 2008 equal to the net price paid by him, that is, €340,385, and his entitlement to capital allowances will be based on that amount at the rates available under the urban renewal scheme.

\*NOTE: When calculating the formula for "the net price paid" in *Section 279* the numerator "C" in the formula should be the amount of construction expenditure (incurred in the qualifying period for the scheme) as reduced in accordance with subsections (5) and (7) of *Section 270*. The denominator "C" in the original formula - now "D" in the revised formula - should include the full amount of expenditure incurred on the construction of the building or structure i.e. before any restrictions and whether or not incurred in the qualifying period for the particular scheme.

### **Relief under General Industrial Buildings Regime**

As €20,000 of the expenditure on the building is attributable to August 2008 (a period falling outside the qualifying period for the urban renewal scheme), that amount must be considered for relief under the general capital allowance regime for industrial buildings. Again, using the *Section 279* formula, the amount of relief available to the purchaser in respect of this element of the expenditure is determined as follows:

$$\text{€}600,000 \times \frac{\text{€}20,000}{\text{€}420,000 + \text{€}100,000} = \text{€}23,077$$

X is deemed to have incurred construction expenditure of €23,077 on 1 October 2008 under the general industrial buildings regime and capital allowances on this element of the relief are available at the rate of 4% per annum over 25 years.

## PROPERTY-BASED INCENTIVE SCHEMES – 15% TEST

### Transitional Arrangements for Property-based Incentive Schemes - test for work carried out by 31 December 2006

#### Extension of Qualifying Period

Finance Act 2006 extended the termination date by which qualifying construction<sup>1</sup> expenditure can be incurred under most of the property-based incentive schemes. It also extended the termination date by which construction expenditure incurred on registered hotels and registered holiday camps can continue to qualify for capital allowance write off over 7 years as opposed to the new 25 year write off for such projects. The termination date has been extended from 31 July 2006 to 31 December 2006 where existing conditions are met and further extended to 31 July 2008 where additional conditions are met. The full amount of the construction expenditure incurred during 2006 can qualify for capital allowances. However, relief is restricted to 75% of the expenditure incurred in 2007 and 50% of the expenditure incurred in the period 1 January 2008 to 31 July 2008.

<sup>1</sup>Where the word 'construction' is used in this article, it also includes 'refurbishment' and, where appropriate, 'conversion'.

#### Existing Conditions

For the buildings and schemes listed below the extended deadline of 31 July 2008 is subject to a number of conditions that pre-date Finance Act 2006. For most of the schemes, a full and valid planning application must have been made by 31 December 2004. In the case of an urban renewal project, a 15% local authority certificate must have been issued by 30 September 2003. In the case of a multi-storey car park, a 15% local authority certificate must have been issued by 31 December 2003. In the case of a third level education building, an application must have been made to the Minister for Finance by 31 December 2004.

#### New 15% Condition

Finance Act 2006 introduced a new condition to be met by projects seeking to avail of the extension to 31 July 2008. This requires work to the value of at least 15% of the actual construction costs of a particular building/development to have been carried out on or before 31 December 2006. This article is concerned mainly with those schemes that do **not** require a local authority to certify that this condition has been met. The schemes in question are -

- Urban Renewal (residential buildings)
- Rural Renewal (residential buildings)
- Town Renewal (residential buildings)
- Student Accommodation
- Multi-Storey Car Parks
- Third Level Education Buildings
- Living over the Shop
- Park and Ride
- Sports Injury Clinics

While local authority certification is not required, the Tax Acts require the person claiming relief to be able to show that the 15% condition has been met. *Tax Briefing* 63 (page 6)

stated that Revenue expected that builders and developers would arrange for a quantity surveyor or architect to prepare a statement showing clearly the actual work that was carried out on or before 31 December 2006, the construction costs attributable to this work, the actual construction costs to completion of the building and the percentage of the total figure represented by the work that was carried out on or before 31 December 2006. The statement should also contain the name and address of the individual or company that is carrying out the construction, the name and address of the development and the relevant scheme. This statement may be required in the event of an audit by Revenue where the person claiming the relief may have to show that the 15% condition was satisfied. Therefore, a builder or developer who sells a completed building should provide this statement to the purchaser who will be claiming the relief together with the usual statement of costs and certificates of compliance/reasonable cost/consistency as appropriate.

### **Work carried out - costs to be taken into account for the 15% condition**

It should be noted that the 15% condition introduced by Finance Act 2006 differs from previous 15% conditions that applied to the urban renewal and multi-storey car park schemes. Firstly, the new 15% test relates to the degree to which work is carried out as opposed to expenditure incurred. Secondly, unlike the earlier tests, the new 15% condition takes no account of the cost of acquiring the site or of any costs associated with that acquisition. It is based solely on the value of construction work actually carried out. The value of work and costs associated with site preparation such as site clearance, laying foundations, power supply, drainage, sanitation and water supply can, however, be taken into account.

As indicated above, the new 15% test is to be established by reference to the value of actual work carried out and not just on the basis of expenditure incurred. No account can be taken of any advance payments made for work that has not yet been carried out. Visible and tangible construction work has to have been carried out and this work has to be manifested as an integral part of the building/development on or before 31 December 2006. Construction costs such as raw materials and labour used, equipment hire and architects fees can be taken into account in establishing the value of the work carried out where these are directly attributable to work actually carried out on the building. For example, an architect's fees can only be taken into account where they are directly attributable to work that has already been carried out. Ongoing work such as project management yet to be delivered as of 31 December 2006 is not to be taken into account. Work that is carried out 'off-site' or work that is involved in the assembly of a part of a building but that has not yet been integrated into the building is not to be taken into account. For example, while the expenditure on the work involved in assembling a bathroom pod or in assembling a roof-frame could ultimately be treated as qualifying construction costs, it is not to be taken into account for the purposes of establishing the value of the work that has been carried out until such time as the bathroom pod or roof-frame has actually been put in place and integrated into the building. The value of the work which is established as actually carried out on this basis on or before 31 December 2006 must then be compared to the sum of that value and the value of the work carried out after 31 December 2006 (i.e. the overall cost of the project) to establish if the 15% test has been met.

### **Local Authority Certification**

The focus of this article has been on those schemes not requiring local authority certification in relation to the 15% condition. However, it should be noted that for certain schemes where the extended 31 July 2008 deadline required E.U. Commission approval, the qualifying conditions are more onerous. The schemes in question are -

- Registered Holiday Cottages
- Holiday Camps

- Hotels
- Urban Renewal (commercial and industrial buildings)
- Rural Renewal (commercial and industrial buildings)
- Town Renewal (commercial and industrial buildings)

For these schemes, Finance Act 2006 requires a binding contract in writing under which the expenditure on the construction of the building/development is to be incurred to have been in place on or before 31 July 2006. It also requires local authority certification that work to the value of at least 15% of the actual construction costs was carried out on or before 31 December 2006. An application for a certificate must be made on or before 31 January 2007. Where satisfied, local authorities must issue certificates on or before 30 March 2007. Guidelines in relation to local authority certification have been issued by the **Department of the Environment, Heritage and Local Government**. It should be noted that the criteria set out above for determining the value of work carried out apply also in the case of these schemes and that local authorities will have regard to these criteria in determining whether a 15% certificate is to be issued.

### **Exceptions to 15% Condition**

In the cases of nursing home residential units and the general countrywide refurbishment scheme, the extension to 31 July 2008 applies without having to satisfy the 15% condition.

### **Building/Development**

The Finance Act 2006 refers to individual buildings. However, where there are several buildings involved in a development as, for example, in the case of a housing estate or a student accommodation development, the 15% condition will be regarded as met for each building where work to the value of 15% of the actual construction costs of all buildings in the development has been carried out on or before 31 December 2006.

Meeting the 15% condition will not of course be an issue in the case of individual buildings in a development completed in 2006 as work to the value of 100% of their construction costs will have been carried out before 31 December 2006. The value of the work on these buildings will count towards achieving the 15% condition where the option is taken to treat a development as one entity for the purpose of that condition. However, it is possible that where projected costs for a development are exceeded on some buildings constructed after 31 December 2006 that the 15% condition is not met when the total development costs are taken into account.

It should be noted that the option to look at an overall development rather than at each individual building in that development only applies in relation to the 15% condition. It is not an option in relation to the 75% and 50% caps or restrictions on qualifying expenditure incurred during 2007 and 2008, respectively and apportionment of relief among all buildings in a development is not possible. For example, a person who purchases a house that was constructed during 2006 will, subject to excluding site cost etc, qualify for 100% relief while a person who purchases a house that was constructed between January and July 2008 will only qualify for relief on 50% of the expenditure. Where construction spans more than one year the relevant cap will apply to the portion of expenditure incurred in each year. **Tax Briefing 63** (Capital Allowances and Property-Based Incentive Schemes) has details of the 75% and 50% restrictions on the amount of expenditure qualifying for relief.